

MECHANICS OF REPLACEMENT ALTERNATIVES

VALUE ADDED TAXES

1. Subtraction Method Business VAT

Tax base is equal to gross receipts less costs of intermediate goods. This VAT would be essentially an origin-based tax on the value of goods and services produced within the state with possible apportionment of exports to make it mimic the destination-based attributes of the B&O.

Imports: Imports of intermediate goods would be treated as origin based (i.e. would be fully deductible). Unitary accounting would be required for multistate firms to avoid tax evasion.

Exports: Firms that are engaged in exporting out of state would multiply their taxable base by some form of apportionment factor in order to maintain competitiveness of current business tax system.

Exemptions: Limited exemptions can be implemented on an entity/activity basis.

Treatment of capital expenditures: We propose not to exclude capital expenditures or depreciation from the tax base. However, excluding capital expenditures or depreciation could be done as a mechanism to make Washington businesses more competitive.

2. Invoice Method GST

Tax base is sales at every stage with a credit for taxes paid on intermediate goods and services purchased by registered taxpayers.

The legal incidence of the tax is on the buyer.

This is essentially a destination-based tax on the value of goods and services consumed in the state.

Imports: Do not have a credit for imports of intermediate goods purchased by enterprises. Goods purchased by final consumer subject to use tax.

Exports: X-rate the exported goods. In other words, the out-of-state purchaser does not pay the GST. The retailer receives a credit for a percentage of the GST paid at previous levels. This percentage could be 100 percent, in which case the exports would be zero-rated.

Exemptions: Products and entities can be exempted to reduce regressivity and administrative costs.

Local taxes: Local governments would continue to impose essentially a local sales tax on retail transactions. The local base would be similar to the current RST base (e.g. business services would not be included). Retailers would continue to provide information on location of sales so that the local tax could be distributed to local governments.

3. Progressive VAT (designed on the basis of the Hall-Rabushka Flat Tax)

Business tax base is gross receipts by all enterprises less costs of intermediate goods and services and the cost of wage compensation to employees. Employees are required to register as taxpayers and must pay tax on wages received from employers in the state. The same rate of tax and exemption level applies to all registered taxpayers. Employees of non-taxable organizations including government and agencies pay same tax rate.

Exemptions: \$20,000 exemption per registered taxpayer.

The tax is essentially an origin-based value added tax split between the businesses and employees (who are considered value-adding entities in their own right). The extension of an exemption to the employee component of value added relieves tax burdens on low-income earners and makes the tax progressive. There is no need to exempt taxes on necessities for this purpose.

Purchases of imported intermediate goods and services by enterprises are fully subtracted. For exporting firms, some form of apportionment of the business part of the tax may be applied in order to mimic the destination (competitive) component of the current business tax system.

Revenue: Same as subtraction VAT less revenue lost from exemptions for employees. DOR to calculate.

(Impacts of progressive VAT option yet to be determined.)

PERSONAL AND CORPORATE INCOME TAXES

1. Flat Rate Personal Income Tax

Starting point will be adjusted gross income (AGI) based on federal income tax laws. Taxpayers only file state returns if a federal return is required.

A credit will be allowed for income taxes paid to other states.

Low-income tax relief is provided by means of a \$20,000 deduction for all returns. Other options would be to increase or lower the deduction level to adjust the overall impact of the proposal. Another means of providing low-income relief is to allow a deduction or exemption based on family size. (*Debbe and Lily will decide.*)

Owners of sole-proprietors, partnerships and sub-chapter S corporations will be allowed a credit against their personal income taxes equal to their distributive share of the amount of B&O taxes paid by the entity.

2. Graduated Personal Income Tax

This alternative is a personal income tax with graduated rates. There will be two systems of rates for single/separate and joint/head of household. Income threshold levels are tied to the federal brackets as follows:

Filing Status	Income Threshold
Single/ Married Filing Separate	\$0 - \$24,950
	\$24,950 - \$60,325
	Over \$60,325
Joint/ Head of Household	\$0 - \$49,900
	\$49,900 - \$120,650
	Over \$120,650

Starting point will be adjusted gross income (AGI) based on federal income tax laws.

Low-income tax relief is provided by means of a \$20,000 deduction for all returns. Other options would be to increase or lower the deduction level to adjust the overall impact of the proposal. Another means of providing low income relief is to allow a deduction/exemption based on family size. (*Debbe and Lily will decide.*)

Owners of sole-proprietors, partnerships and sub chapter S corporations will be allowed a credit against their personal income taxes equal to the amount of B&O taxes paid. This credit would not be refundable.

3. Corporate Income Tax and Flat Rate Personal Income Tax

Corporate income tax has a single rate and three-factor apportionment. Federal net income is the measure of the tax base.

Income is apportioned by means of equally weighting three factors (sales, property, and payroll). There are other options for apportionment such as double weighting the sales factor.